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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, A. D. 1942.

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No. 189

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FRANK A. BARLOW, Trustee of the Estate of the Liberty  
Poster Company, a corporation, Bankrupt,  
*Petitioner,*

v.

W. P. BUDGE, Claimant,  
*Respondent.*

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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**OPINIONS BELOW**

The Findings and Conclusions of the Referee in  
Bankruptcy were filed April 11, 1940. (R. 44-47). The  
first opinion of the United States District Court for  
the District of Minnesota adopted the Findings and

Conclusions of the Referee and was filed December 31, 1940. (R. 70-71).

The second opinion on re-hearing before the United States District Court, District of Minnesota, was filed February 18, 1941. (R. 74).

The United States Circuit Court of Appeals, Eighth Circuit, filed an opinion on April 20, 1942, (R. 82) affirming the United States District Court and this opinion is reported in 127 Federal 2nd, Page 440.

A Petition for re-hearing was filed and denied on May 11, 1942. (R. 105).

#### **JURISDICTION**

The Petition for a Writ of Certiorari to the Circuit Court of Appeals, Eighth Circuit, was filed June 29, 1942.

The jurisdiction of this Court is invoked under Title 28, U. S. C., Section 347.

#### **QUESTION PRESENTED**

The case arises under the Federal Bankruptcy Act.

The question is whether the claim of a director and officer of a bankrupt corporation, for money loaned in good faith to the corporation and used by it in its corporate business, must be subordinated to the claims of general creditors which arose after the loans were made to and the money expended by the Corporation.

#### **STATEMENT OF FACTS**

The Petitioner is the Trustee of Liberty Poster Company, bankrupt, adjudicated as such on April 22, 1939. (R. 3). The matter was referred to Honorable Walter H. Newton, Referee in Bankruptcy, on the same date. (R. 3). The Trustee's Bond was approved May 17, 1939. (R. 3).

The Respondent, Budge, was an officer and director of the Company and owned one third of its stock. He filed a claim for salary for the years 1930, 1931 and for cash advanced between January 31, 1935, and April 20, 1937, in the total sum of \$8,800.00 against which certain credits were acknowledged between November 1, 1930, and September 8, 1937, in the sum of \$3,310.00 leaving a balance of \$4,970.00 for which amount the claim was filed. (R. 10).

The Trustee objected to the claim on the grounds that the claimant, with two other shareholders, was engaged in a "joint venture or partnership" (R. 7), although operating under a corporate name; that all debts incurred after January 1, 1937, by the corporation were with "intent on the part of the bankrupt Rose, Budge and Morrissey of defrauding those persons" (R. 8) and that the money received by the corporation from Budge was a contribution to capital. (R. 8).

The Referee found that claimant was paid \$2,060.00, which was accepted by him in full compensation of his salary aggregating \$2,080.00 for the years 1930 and 1931, (R. 46) and \$1,250.00 as part re-payment of sums advanced by him to the corporation, making the total credit of \$3,310.00 and leaving a balance of \$4,950.00 (R. 46); and that all of the cash advanced by the Respondent was paid to the corporation in good faith for its benefit. (R. 46).

The claim was allowed at \$4,950.00.

On April 15, 1941, the Petitioner filed an application for review of the Referee's Order. (R. 47-53). The Referee's Certificate of Review, Findings and Order allowing the claim of the Respondent was filed May 2, 1940. (R. 53 to 61 inclusive). The good faith of the Respondent was admitted by the attorneys for the Trustee. (R. 57). The Referee attached to his Find-

ings a memorandum (R. 62) from which it clearly appears that, in reaching his conclusions, he closely scrutinized the good faith of the Respondent, any abuse of the fiduciary power of the Respondent, as an officer of the corporation, and the benefit received by the corporation from the advances made by the Respondent. (R. 62).

The District Court, in its opinion sustaining the Referee's Findings and upon consideration of the entire Record, (R. 70), found that the Referee had given consideration to all material facts presented before him; that the loan was openly made for the purpose of saving and not wrecking the corporation (R. 71) and that, although the corporate forms were disregarded, no substantial prejudice resulted to anyone and that nothing in the Record suggested "the history of a deliberate and carefully planned attempt" on the part of Budge to accomplish a fraud on creditors and allowed the claim of Budge and adopted the Findings and Conclusions of the Referee as its own.

On January 10, 1941, the Petitioner filed a Petition for re-hearing. (R. 71-74). This was heard on January 18, 1941, and denied on February 18, 1941. (R. 74).

Petitioner appealed to the United States Circuit Court of Appeals, Eighth Circuit, from the Order of the District Court, (R. 75-76), on April 20, 1942. The United States Circuit Court of Appeals, Eighth Circuit, filed its opinion, in which it held that "where a claimant is a person or corporation having complete ownership and control of a bankrupt corporation, which the claimant has organized, controlled and operated as a mere agent, adjunct or instrumentality for his own purposes and benefit, the courts will disregard the corporate entity at least so far as other creditors are concerned and deny to the alleged creditor participation

on a parity with them. (Cases cited) But, while the dealings of an officer, director or stockholder who files a claim against the bankrupt corporation for money loaned to it will be subjected to rigorous scrutiny and the claimant required to prove the good faith of the transaction upon which the claim is based and also its fairness from the point of view of the corporation and those interested in it (*Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590, 599; *Pepper v. Litton*, 308 U. S. 295, 306), his relation to the bankrupt will not prevent the allowance of his claim on a parity with other creditors if he can show that the money was needed by the corporation and was used for proper corporate purposes and that the transaction between him and the corporation was open, honest and free from unfairness or fault." (Cases cited) (R. 87). The Court further held that it was the duty and responsibility of the bankruptcy court to determine whether, under the applicable law, the claim of Budge was upon an equitable parity with the claim of other creditors. (R. 87).

The order of the District Court was affirmed with costs. (R. 92).

On May 4, 1942, the Petitioner made application for a re-hearing. (R. 93-104). This was denied on May 11, 1942. (R. 105).

On May 28, 1942, an application for stay of mandate was filed (R. 105) and the Order staying the issuance of the mandate was filed May 29, 1942. (R. 107).

On June 29, 1942, the Trustee filed a Petition for a Writ of Certiorari to the United States Circuit Court of Appeals, Eighth Circuit, together with his supporting Brief and Record.

## ARGUMENT

I. The proposition urged by Petitioner may be stated as follows:

The claim of one interested in the business and management of a corporation for money advanced in good faith in an effort to keep it solvent must be subordinated to the claims of future general creditors of the Corporation.

This proposition penalizes every honest attempt of a stockholder, officer or director to keep a corporation in business by advancing his own money to it. No authority for this unusual and inequitable contention is cited. The cases upon which petitioner relies (*Pepper v. Litton*, 308 U. S. 295; *Peterson v. John Hancock Mutual Life Insurance Company*, 116 F. (2d) 148; *Quinn v. National Bank*, 32 F. (2d) 762; *Sampsell v. Imperial Paper & Color Corporation*, 313 U. S. 215; *Taylor v. Standard Gas & Electric Company*, 306 U. S. 307) state no such doctrine. Where they enforce subordination it is because of a lack of good faith by those in control of a corporation, a misuse of corporate opportunity, discrimination for the benefit of insiders, or some other breach of a fiduciary duty owed. In the present case Petitioner not only does not deny the good faith of Respondent but has admitted it. (R. 57).

The question thus presented is a narrow one and completely disposed of by the finding and admission of Respondent's good faith. A proper statement of the rule applicable here appears in *Arnold v. Phillips*, 117 F. (2) 497, 503: "That the lender dominates the corporation opens the transaction to closer examination; it does not ipso facto invalidate it. We find here no proof of mala fides, or that the money was not fully paid to and used by the corporation in an honest effort to carry on its own business."



The Respondent was required to assume and did assume the burden of proof, not only of the amount of his claim but also of his good faith. (R. 62-63). More is not required of him.

The Referee, in his memorandum, indicated clearly that the rule laid down in the *Arnold v. Phillips* case was followed, as appears from his statement "to insure this fairness and to avoid any abuse of the fiduciary powers of such an official, transactions of this character should be most closely scrutinized," (R. 62), resting his decision within the rule as laid down in *Pepper v. Litton*, 308 U. S. 295, 306, and *Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590, 599.

The United States District Court held the controlling features of the case to be the conceded good faith of the respondent and benefit to the corporation, (R. 71), basing its opinion within the rule laid down by the Circuit Court of Appeals in this case, (R. 87), and in accordance with the rule laid down by this Court in *Geddes v. Anaconda Copper Mining Co.* and *Pepper v. Litton*, *supra*.

Therefore, it appears that there is no basis upon which the Petitioner can justify a complaint that there is a conflict here between the decisions of the lower Courts and the opinions of this Court.

II. The second complaint of the Petitioner is that the issues between the Respondent and creditors, whose claims arose after July 1, 1937, were not considered by the Court. The issue was before the Referee. (R. 43 and 52). It was considered by the Referee in his summary of evidence, (R. 58), wherein he stated "No evidence whatever was presented that any creditor was (mislead) by any representation from Budge or any other officer as to the transactions mentioned in the account. Everything was in the utmost good faith." (R. 58).

It was again referred to in the Petitioner's application for a review, (R. 66), and considered by the United States District Court who "considered the entire record." (R. 70). It was again directed to the attention of the Court by Petitioner in his application for rehearing, (R. 72), and considered by the United States District Court on re-hearing. (R. 74).

The Circuit Court of Appeals in its opinion, considered the rights of creditors, whose claims were created after July 1, 1937, saying: "The evidence does not justify an inference that Budge manipulated the affairs of the corporation for his own personal advantage. The inference which is justified by the evidence is that the advances which Budge made were made in good faith to enable the bankrupt to meet pressing obligations and to remain in business. The advances were made before the creditors, to whose claims it is now contended Budge's claim should be subordinated, had become creditors." (R. 86 and 87).

On this point, the Petitioner confuses his failure to prevail after full consideration with the denial of a substantial procedural right. No such denial exists in this case.

#### CONCLUSION

The Respondent is equitably entitled to parity with general creditors of the bankrupt corporation. The Referee and the Trial Court so held and the Circuit Court of Appeals found no reason to reverse. The petition in this case presents no substantial question for review and should be denied.

Respectfully submitted,

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